theirview

Making the most of the new industrial policy

It is an opportunity to address the problems of low R&D spending and tough competition from cheap imports from China

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The framing of the new industrial policy should be seen as an opportunity to chart a meaningful path for industry's role in India's development. The recently released discussion paper by the department of industrial policy and promotion mentions two points that need to be examined closely to grasp the headwinds industry will have to navigate: first, industry's inadequate expenditure on research and development (R&D). And second, micro, the small and medium enterprises sector facing tough competition from cheap imports from China and other countries with which India has free trade agreements.

To put the first point into context, Huawei's R&D expenditure (around $6.5 billion) is about the same or more than that of Indian industry, while Microsoft spends (around $12 billion) about the same as the Indian government. Regarding the second point, the consequence of the inflation-targeting framework and its impact on Indian industry via the exchange rate (resulting in cheaper imports from China) would need to be studied in greater detail.

INDUSTRIAL R&D—INDIA AN OUTLIER

If India has to realize its ambition of increasing the number of global Indian companies in the Fortune 500 list, and raise its share of manufacturing in GDP (gross domestic product) to around 25% from 17% currently, industry will have to significantly step up its R&D expenditure. Currently, R&D spending amounts to around 0.9% of GDP. The private sector in India accounts for around 35% of the country's total R&D spending, compared to many advanced economies as well as China, where the corresponding number is around 70%. This will need to be addressed by the new industrial policy, else it risks remaining a structural headwind that will continue to weigh on India's productivity growth going forward.

While the new policy will look to provide a fillip to Make In India, policymakers should be cognizant of "Made in China 2025". One is aware of the high credit to GDP ratio in China and the fact that the Chinese economy has been slowing gradually—although a look at indicators in China, such as loan growth, electricity production, railway freight and fixed asset investment (FAI), suggest that GDP growth in China should remain comfortably within the 6.5%-7.0% range and is unlikely to fall off the cliff any time soon. China is an $11-trillion economy, and its R&D spending as a percent of GDP is around 2.1%. Indian industry has some way to go.

In the list of the top 2,500 global R&D spenders, there are 26 Indian companies compared to over 300 Chinese companies. In the top 10 global industrial R&D sectors by spending, India has a presence largely in three sectors—pharmaceuticals and biotechnology, automobiles and parts, and software and computer services. It has very little or no presence in other top sectors (*see table*) as opposed to China that has a presence in each of them. The new industrial policy should aim to push for technological deepening in sectors where Indian companies are globally competitive and also provide a road map to enable industry to diversify across sectors. Healthcare is one sector where there is significant potential to increase both public and private R&D expenditure. Focusing on healthcare equipment and services for example, where India has no R&D presence, would assist in technological deepening within the healthcare sector—and also in providing affordable and accessible healthcare through "frugal" medical devices.

IS THE INFLATION-TARGETING FRAMEWORK HURTING INDUSTRY?

Turning to the issue of tough competition from cheap imports from China—recent articles in *Mint* have spoken about the impact of a strong rupee on Indian industry and the economy. The Indian rupee has been overvalued for quite some time (on a real effective exchange rate basis for over two years now). This was also raised by my colleague Rajan Govil in an article in May 2015 published in the *Financial Express* (goo.gl/UldMkz), in which he made a case for the inflation targeting framework being inappropriate for India. While framing the new industrial policy, it would be important to study the extent to which the inexplicably higher interest rates under the framework may have encouraged strong capital flows resulting in rupee strength that is hurting domestic industry (due to cheaper imports). The higher interest rates have also hurt credit to industry.

China's exports to India totalled over $60 billion in FY2016-17. This is not insignificant given that Indian manufacturing on a gross value added basis is around $315 billion. In the current fiscal year, China's exports to India have grown almost 17% year-on-year on a year-to-date basis as of July. Demand in India for Chinese electronics and electrical equipment from globally competitive Chinese firms can be expected to grow going forward (currently around 35% of the total Chinese exports to India are items such as electrical machinery and equipment and parts). For now, Indian firms may have to contend with a stronger rupee. To successfully compete with their Chinese counterparts, they will need to spend a lot more than they currently do on R&D. By all means, make the industrial policy a consultative process, but it would need to be well coordinated across various ministries and backed by strong research.

Comments are welcome at theirview@livemint.com

Top 2,500 global R&D spenders

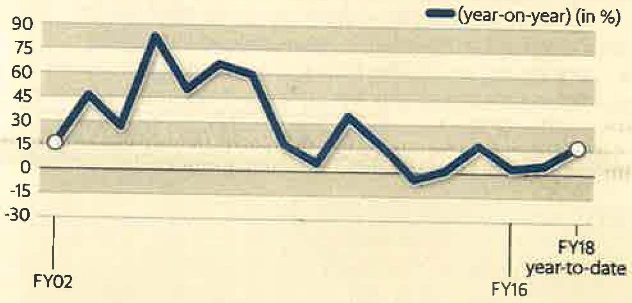
Indian industry still has a long way to go

Rank	Sector	Total no. of companies	No. of Indian companies	No. of Chinese companies
1	Pharmaceuticals & biotechnology	316	8	21
2	Automobiles & parts	155	6	28
3	Technology hardware & equipment	316	0	37
4	Software & computer services	275	5	32
5	Electronic & electrical equipment	229	0	39
6	Industrial engineering	199	1	30
7	Chemicals	133	0	10
8	Aerospace & defence	56	0	6
9	General industrials	96	0	15
10	Oil & gas	49	1	6
	Total no. of companies (top 10 sectors)	1,824	21	224
	Total (2,500 firms)	2,500	26	301

Source: Naushad Forbes, "India's National Innovation System: Transformed Or Half Formed", chapter in Rakesh Mohan's book, 'India Transformed: 25 Years Of Economic Reforms'; EU Industrial R&D Investment Scoreboard (2015); CTIER.

China's exports to India

The exports totalled over $60 billion in FY17



GRAPHIC: VIPUL SHARMA/MINT

Source: CEIC, Marketnomix